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## THE EUROPEAN COMMUNITY AND SRI LANKA

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The following memorandum outlines relations between the Community and Sri Lanka.

It is published on the occasion of the fourth session of the EC-Sri Lanka Joint Commission in Brussels on May 4th and 5th 1981.

## THE EUROPEAN COMMUNITY AND SRI LANKA

### Introduction

The "resplendent isle", which is the translation of Sri Lanka, has a population estimated at 14.6 million (mid-1979), which grew at a rate of 1.7 % a year between 1970 and 1979.

The country's per capita GNP was estimated at \$ 220 for 1979. The annual rate of growth, at constant prices, was 1.2 % for the period 1970-77, but rose to 15.3 % for the period 1977-79.

This sharp increase must be attributed to the economic reforms initiated by the Government which took office in 1977, following Parliamentary elections which had resulted in the overwhelming victory of the United National Party, led by Mr. J.R. Jayawardene.

The Government has followed up its initial programme of economic reforms with additional measures, aimed at the further liberalization of the economy. It has sought to ensure adequate incentives for the productive sectors of the economy and to develop a strategy of export-led growth.

Signs that the economy was expanding too rapidly appeared late in 1979. The rate of inflation, for example, climbed to an annual rate of 32 %, while construction costs rose by over 50 %. The Government responded in early 1980 with a number of corrective measures including cuts in projects.

The Government's development programme is aimed at restructuring the national economy during the 1980s. The goals include greater self sufficiency in agriculture; a change in the structure of exports, with emphasis on manufactures rather than on tea crops, and a major overhaul of the country's economic infrastructure, including transportation, telecommunications, housing and water supply.

### Development of EC - Sri Lanka relations

Sri Lanka established diplomatic relations with the EC in 1971. Britain's accession to the Community in 1973, and the Declaration by the enlarged Community of its intention to develop trade relations with Asian members of the Commonwealth, led Sri Lanka to seek a more formal relationship with the EC. In 1974 it requested negotiations with a view to entering into a commercial cooperation agreement (CCA in Community jargon), along the lines of the one concluded by India in 1973.

### Conclusion of a commercial cooperation agreement (CCA)

Negotiations duly opened in November 1974, with the head of the Commission delegation describing the CCA as the instrument by which the Community hoped to expand and diversify its trade with developing countries. They were successfully concluded the following month and the new agreement was signed on 22 July 1975.

It came into force on 1 December 1975. As it was concluded for a 5-year period with automatic year to year extension if neither of the parties denounce it, the question of the negotiation of a new cooperation agreement has already been raised in the framework of the institutional machinery set up under the CCA. However, as the CCA, and the results achieved under it, will be the starting point for any future negotiations, it merits analysis.

### Brief description of the CCA

#### General provisions

The CCA is a non-preferential agreement which seeks to develop trade between the EEC and Sri Lanka "to as high a level as possible" on the basis of comparative advantage and mutual benefit. The two sides undertake, therefore, to "promote the development and diversification" of their trade with each other and to take "all appropriate steps" to this end.

The CCA also provides for economic cooperation, "when linked to trade" and "in the light of developments in their economic policies". This last is a reference to the fact that the EC's jurisdiction does not extend as yet to all areas of economic activity. Cooperation, like the Community itself, must follow an "evolutionary" pattern.

Cooperation is not limited to the territory of the EC and Sri Lanka: the agreement provides that the two sides will try "to increase their cooperation in commercial and related economic matters in third countries, so far as it is in their mutual interest".

Although the CCA is a non-preferential agreement, there are several references to tariffs all the same. The EC and Sri Lanka agree to grant each other most-favoured-nation treatment. In an annexe the Community declares its readiness to bind tariff reductions and suspensions already applied autonomously to six products: dessicated coconut; tea; whole pepper for industrial use; cinnamon; cardamon and East Indian kips (bovine leather). This commitment was implemented in the course of the last MTN negotiation, the so-called "Tokyo-Round".

In a Declaration on tariff adjustments, the EC declares itself ready to take Sri Lanka's export interests into account when making improvements to its GSP scheme and examine in the Joint Commission the possibilities for further tariff adjustments. Sri Lanka undertakes to make similar adjustments, "taking into consideration its development needs".

### Joint Commission

The general supervision and implementation of the CCA has been entrusted to a Joint Commission (on which the Community is represented by the European Commission, assisted by representatives of the member states). It is required to devise ways of overcoming trade barriers, encouraging economic and commercial cooperation and facilitating exchanges of information and contacts on all relevant subjects.

The Joint Commission also has responsibility for ensuring the proper functioning of any sectoral agreements between the EC and Sri Lanka. There are a number of such agreements, in fact, covering handicrafts, handloom fabrics, coir (1) products and textiles.

### Sectoral agreements

In 1970 the EC opened duty free quotas on an annual basis for handicrafts from India. This unilateral concession was extended to Sri Lanka under an agreement concluded in 1971. A similar arrangement covering handloom fabrics in silk and cotton was extended to Sri Lanka in 1975.

A bilateral agreement was negotiated for coir products, of which Sri Lanka is a major producer. Since 1978 tariffs on these products have been suspended at zero through the GSP(2).

The most important sectoral agreement covers textiles. It was concluded in 1977 as one of a series of bilateral agreements negotiated by the Community in the context of the Multifibres Arrangement. Several Community countries having supported the World Bank in financing the expansion of the burgeoning garment industry in Sri Lanka, the EC felt it had a moral obligation to fulfil.

It therefore agreed to annual import quotas totalling over nine million garments, distributed over 5 of the 8 highly sensitive categories of textile products. This was well in excess of Sri Lanka's exports in 1976, the base year for the textile negotiations. Sri Lanka's total exports to the EC amounted to less than 600,000 pieces that year.

### Operation of the CCA

After a slow start, the Joint Commission began to pick up momentum after its second session, which was delayed until 1978. The Sri Lankan government was firmly committed by then to developing export-oriented industries, and therefore sought the Community's help for its efforts to attract European partners in joint ventures and in promoting exports to the EC. There was some progress on both points and the Community agreed in principle to finance a study of the long-term potential for economic cooperation between the EC and Sri Lanka.

By the third session, held in Colombo in November 1979, the Joint Commission was active in several areas. The Sri Lankan government had decided to open two trade and investment centres in the EC, the first in Copenhagen, the second in Düsseldorf. The EC undertook to provide complete financial support for both centres, and for at least the first year of operations to begin with.

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(1) Coconut fibres

(2) Generalized System of Preferences.

During the third session the EC also undertook to help Sri Lanka in its efforts to promote joint ventures with European partners in a number of sectors, including tea-bagging, deep-sea fishing, the processing of ilmenite<sup>(1)</sup> and graphite and, finally, petroleum exploration.

#### Results on the eve of the Fourth Session of the Joint Commission

On the eve of the fourth session, scheduled for May 4 and 5 in Brussels, the following progress report could be made:

##### Sri Lanka Trade and Investment Centres

The Copenhagen office was formally inaugurated in June 1980, and within a period of 9 months had promoted investments by Scandinavian firms for the manufacture of steel enclosures, cotton carpets and computer components. It had also initiated exports from Sri Lanka of tea bags, fashion garments and other textile products.

The Centre in Düsseldorf was also inaugurated in June 1980. By March 1981 it had initiated a number of joint ventures, covering such diverse products as weighing machines, sunglasses, coir products and jewellery.

The EC has agreed, under its 1981 trade promotion programme, to meet all the costs of the Copenhagen office for the second year running and to share in the costs of the Düsseldorf Centre. The Community has also agreed to finance the publication of an Investment Guide for Sri Lanka.

##### Trade Promotion activities

They include sending an expert in jewellery to Sri Lanka for a 12-month period; helping Sri Lankan exporters take part in trade fairs (in Milan and Brussels in 1981) and organizing trade missions. One such mission (in early 1981) brought together exporters of jewellery and dessicated coconut; a second (scheduled for September) will cover cut flowers, tropical plants and aquarium fish.

##### Economic cooperation

Sri Lanka has been trying to persuade the German fishing industry to invest in the fisheries sector. The latter has suggested sending a fact finding mission.

In an attempt to overcome its energy shortage, Sri Lanka has suggested that the EC-supported development projects in rural areas include energy as an element. The Commission is prepared to help Sri Lanka work out a medium-term energy programme which emphasizes conventional sources.

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(1) Oxide of iron and titanium used amongst other things for the manufacture of heat proof paints.

### Generalized system of preferences

Sri Lanka has been a beneficiary of the Community's GSP scheme since it was initiated in 1971. In the early years the level of utilization was low because of the limited size of the country's manufacturing industry. Product coverage has been expanded from 1974 onwards to include more processed agricultural products, including many of export interest to Sri Lanka - shrimps, instant tea, coconut oil, dessicated coconut, flue-cured Virginia tobacco, spices, certain cut flowers and tropical fruit cocktails.

Sri Lanka has drawn up lists of agricultural products for which it would like duty free entry under the GSP. The Commission, even while examining these lists, has pointed out to Sri Lanka that its exporters are not making full use of the tariff concessions already available to them.

Import statistics suggest that this is the case even as regards tea in packets. To increase the level of utilization, a GSP seminar was organized by the Commission in Sri Lanka in 1980.

### Textiles

The 1977 bilateral agreement has been working to the satisfaction of both Sri Lanka and the EC. During the third session of the Joint Commission, the Community delegation noted that the utilization rate could be improved. It suggested that further use be made of the agreement's flexibility provisions. Since then Sri Lanka has expressed its intention to use the provisions for inter-country transfers.

### Trade

The EC is Sri Lanka's major trading partner, both as an importer of Sri Lankan products and a supplier of machinery and other manufacturers. Sri Lanka's principal exports - such as tea, fresh or dried coconuts, natural rubber, coir fibre and dessicated coconut enter the EC duty free. Garments are now leading imports.

The Community's main exports to Sri Lanka include machinery and transport equipment, foodstuffs and other manufactured products.

The following Table shows the Community's trade with Sri Lanka between 1973 and 1980:

#### EC TRADE WITH SRI LANKA

(in million ECU)(1)

	<u>EC Imports</u>	<u>EC Exports</u>	<u>Trade balance</u>
1973	87	78	- 9
1974	130	100	- 30
1975	104	120	+ 16
1976	132	107	- 25
1977	167	115	- 52
1978	147	195	+ 48
1979	181	199	+ 18
1979 (10 mos)	151	158	+ 7
1980 (10 mos)	177	229	+ 52

The deficits recorded by Sri Lanka since 1978 reflect the more liberal trading policies introduced by the Government after 1977.

(1) ECU: European Unit of Account

### Development assistance

Sri Lanka has been an important beneficiary of the Community's food aid programme since its inception. The following Table shows the quantities supplied annually between 1975 and 1980:

Food aid to Sri Lanka, 1975-80  
(in tonnes)

	<u>1975</u>	<u>1976</u>	<u>1977</u>	<u>1978</u>	<u>1979</u>	<u>1980</u>
Cereals	20,000	15,000	30,000	27,000	19,000	20,000
Milk powder	1,000	1,300	2,000	4,375	-	500
Butteroil	250	160	200	200	200	200

### Financial and technical aid

The EC instituted its rural development programme for developing countries in Asia and Latin America in 1976. The total funds available that year amounted to ECU 20 million, of which Sri Lanka received ECU 2 million for a reservoir project near Trincomalee.

It received similar amounts in 1977 and 1978 for agricultural projects in the Mahaweli Ganga region. This was raised to ECU 3 million in 1979, for a post-cyclone coconut rehabilitation project.

There was a 5-fold increase in Community aid in 1980, when it reached ECU 15.4 million. This Community aid to developing countries is essentially project-oriented. In other words, the amount going to any one country depends largely on the quality of the projects submitted and the extent to which they conform to the Community's own aid guidelines.

The increase in 1980 was due, therefore, to Sri Lanka having presented a major project in the context of its Mahaweli Programme, a huge development project (dams, hydroelectric power stations and irrigation), requiring expenditures over a number of years.

The Community has also extended technical assistance to Sri Lanka, though for much smaller amounts, in 1976 and 1979. It has also funded projects under its trade promotion programme.

In 1978 the amount earmarked for Sri Lanka under the Community Member States' contribution to the so-called "Special Action" amounted to \$ 15 million.

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The fourth session of the EC-Sri Lanka Joint Commission represents an important step in the cooperation between the European Community and Sri Lanka.

It makes a progress report of EC-Sri Lanka relations and strives for developing joint ventures with European partners and furthering trade promotion activities launched by the two Trade and Investment Centres in Copenhagen and Düsseldorf.



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